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SIPDIS

DEPT FOR SCA/FO, SCA/RA, AND SCA/A
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TREASURY PASS TO LMC DONALD, ABAUKOL, AND JCIORCIARI
OSD FOR BRZEZINSKI

SENSITIVE
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TAGS: [EFIN](#) [EAID](#) [ECON](#) [AF](#)
SUBJECT: UPDATE ON AFGHANISTAN DEBT FORGIVENESS AND DEBT
RESTRUCTURING

REFTEL: KABUL 344

SUMMARY

1.(SBU) Afghanistan and Germany are expected to sign their bilateral debt restructuring agreement later in March. The GOA sent Russia comments and suggested edits to the first draft of their bilateral debt reduction agreement on or about March 12. The Afghans hope to sign this agreement sometime in April. Debt arrears to the Kuwait Fund for Arab Economic Development prevent it from becoming a donor to Afghanistan. Afghanistan's debt to the Czech Republic appears to have been assigned to a private sector actor. The GOA has not yet decided to recognize the new creditor. The Bulgarians have not responded to official GOA communications on the status of this \$47 million debt. Assuming Afghanistan's second IMF PRGF Review is positive, the Russian bilateral is completed, and an IMF debt sustainability analysis is completed, Afghanistan could reach HIPC "Decision Point" in mid-2007. END SUMMARY.

BILATERAL DEBT REDUCTION AND RESTRUCTURING

2.(SBU) Following Afghanistan's agreement with the Paris Club (PC) and its PC creditors in July 2006, the country has been working on completing its Paris Club bilateral agreements with Russia, Germany and the United States. A status update on these three negotiations follows.

- U.S.: The bilateral agreement was signed in September 2006 and it entered into force in March 2007. The amount owed was \$112 million as of March, 2006. (NOTE -Due to type of debt originally extended, immediate reduction in debt amounts not provided).

- Germany: An agreement was reached on the bilateral agreement document, and the GOA expects to sign it in March, 2007. Germany

provided the "debt reduction" option to Afghanistan which will mean an immediate 67% reduction of the outstanding debt. The amount owed is \$44.1 million as of March, 2006. It will be reduced to \$14.5 million upon signing.

- Russia: The first draft of the bilateral agreement was received from Russia on February 20, 2007. The Afghan authorities completed their review and sent their comments and suggested edits to Russia on or about March 12. Russia provided the "debt reduction" option to Afghanistan meaning an immediate 67% reduction (in addition to the upfront 80% reduction from Russia) when the agreement is signed. The amount owed as of March 2006 was \$11.1 billion. Upon signing of the bilateral agreement, this debt will be reduced to approximately \$731 million. The GOA hopes to complete negotiations with Russia in April.

3.(SBU) Each of the above creditors has agreed to forgive 100% of Afghanistan's debt owed to them when Afghanistan successfully completes a program under the Heavily Indebted Poor Country (HIPC) initiative. The HIPC initiative is a program sponsored by the IMF and the World Bank to provide debt relief to the world's poorest countries. Afghanistan is in the process of trying to qualify for the program at this time.

4.(SBU) Afghanistan's three Paris Club creditors have also agreed to capitalize the interest that will accrue on the restructured indebtedness through March, 2009, in order to lessen the financial burden on the country. The total debt of the three creditors above is approximately \$11.3 billion as of March 31, 2006, the measurement date in the Paris Club agreement.

5.(SBU) In addition to the Paris Club creditors above, Afghanistan

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owes six other bilateral creditors approximately \$165 million. These debts have not been serviced in recent years. In conjunction with the Paris Club agreement and Afghanistan's expected entry into the HIPC process in 2007, the country plans to approach these creditors this year for debt relief and/or debt restructuring to comply with its Paris Club agreement. An update of the status of three of the six follows.

- Kuwait Fund for Arab Economic Development (approximately \$19 million): The Kuwait Fund has been seeking a restructuring of this debt for several years. The Kuwait Fund has indicated verbally to the Minister of Finance at the World Bank/IMF annual meetings in Singapore (Sept. 2006) that it would provide debt restructuring based on the terms that Afghanistan receives as part of the HIPC process. We expect meetings with the Kuwait Fund in the coming months to begin this process. Kuwait has indicated that having this debt in arrears is preventing it from providing grant aid to Afghanistan.

- Czech Republic (former Czechoslovakia) (approximately \$64 million): The Czech Republic assigned this debt to a private party in Iran in 2002, and it has now been assigned again in 2006 to a company in Germany. The Government of Afghanistan has not determined whether to recognize this debt at the present time. In October, 2005, Slovakia forgave its share of the amounts owed to the former Czechoslovakia (\$29.3 million, including principal and interest).

- Bulgaria (approximately \$47 million): Bulgaria has provided no official response to Afghanistan's numerous letters for specific debt information. They have been informed that Afghanistan is pursuing HIPC status but no information has been forthcoming from the Bulgarian authorities. Bulgaria alleges that about \$600,000 of its debt is owed to private companies but has provided Afghanistan with no specific details on these cases.

6.(SBU) Afghanistan has recently concluded a loan agreement with the Saudi Fund for Development. It will not be subject to Paris Club/HIPC debt relief as it was only signed and funded within the last 12 months.

MULTILATERAL DEBT

7.(SBU) Afghanistan's main multilateral creditors are the World Bank and the Asian Development Bank. Arrears to these entities were paid (via a grant from a donor) in 2002, and they have been active lenders (and grant providers) to the country in recent years. The amount owed to these two multilateral lenders is approximately \$630 million as of December 2006. The World Bank is expected to provide flow relief (i.e., suspension of debt service payments) on qualifying loans upon Afghanistan's attaining Decision Point in the HIPC process and 100% forgiveness on these same loans when Completion Point under HIPC is reached.

8.(SBU) While Afghanistan is expecting the Asian Development Bank to provide some debt relief, the extent of the relief is not known at this time.

9.(SBU) An amount of approximately \$2 million is owed to the OPEC Fund for International Development, and this debt has not been serviced in recent years.

10.(SBU) Afghanistan also has two loan commitments from the Islamic Development Bank, but no disbursements have been made. They will not be subject to debt relief under HIPC.

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RECENT EVENTS

11.(SBU) IMF and World Bank missions recently visited Kabul (late January-early February) to work with the debt management unit of the Ministry of Finance on reconciliation and verification of its bilateral and multilateral debts. With the data gathered by the missions, a debt sustainability analysis will be prepared which should demonstrate Afghanistan's eligibility for the HIPC program. The GOA is looking for the IMF and World Bank to declare that Afghanistan is "HIPC eligible" in April 2007. Preliminary discussions and negotiations were also held on HIPC "triggers" or benchmarks, and it is expected that the negotiations on the benchmarks will be finalized in March. These benchmarks will have to be achieved in the coming years in order for Afghanistan to achieve "Completion Point" under HIPC. The earliest estimate of reaching "Completion Point" is mid-2009, other things being equal.

12.(SBU) The second review under the IMF's Poverty Reduction and Growth Facility (PRGF) will take place in late April. After this mission, another debt sustainability analysis will be conducted (based on updated debt and export numbers). The GOA expects this analysis to form the basis of a mid-2007 IMF and World Bank notification that Afghanistan has reached its HIPC "Decision Point." After being granted HIPC Decision Point status, the World Bank should suspend some required debt service payments. Afghanistan must continue to maintain satisfactory performance under its PRGF program with the IMF in order to stay on track to reach the HIPC "Completion Point."

COMMENT

13.(SBU) Overall, the process for bilateral and multilateral debt relief is going well. Completion of bilateral negotiations with Russia should put Afghanistan in position for a favorable IMF/World Bank notification that Afghanistan has reached its HIPC "Decision Point." This will have important positive affects on the country's cash flow situation and could help with its credit rating. The key will be the GOA's meeting its IMF PRGF program benchmarks. We understand that the GOA believes it is in fairly good shape, so a HIPC "Decision Point" announcement in mid-2007 is not out of the question. END COMMENT.

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